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Income Tax Benefits for U.S. Citizens Who Go Overseas COMPLETED

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You can order the IRS tax forms and publications mentioned in this publication by writing to:

IRS
P.O. Box 611
Beltsville, MD 20705

Please order *by publication or form number, not by title.*

Introduction

This publication discusses in general terms some provisions of the U.S. federal income tax law that apply to U.S. citizens or resident aliens who live or work abroad and who expect to receive income from foreign sources.

As a U.S. citizen or resident alien, your income generally is subject to U.S. income tax regardless of where you are living. However, several income tax benefits might apply if you meet certain requirements while living abroad. You may be able to exclude from your income a limited amount of your foreign earned income. You also may be able either to exclude or to deduct from gross income part of your allowable housing expenses.

Under tax treaties or conventions that the United States has with many foreign countries, you may be able to reduce your foreign tax liability. And you may be able to claim a credit against your U.S. income tax liability for the foreign income taxes that you have to pay.

Internal Revenue Publications 54, *Tax Guide for U.S. Citizens Abroad*, and 514, *Foreign Tax Credit for U.S. Citizens and Resident Aliens*, provide detailed discussions on the treatment of your foreign income, the foreign tax credit, and the general tax treaty benefits available to you.

Students or professors who receive income from teaching or studying abroad also should get Publication 520, *Tax Information for U.S. Scholars*.

Income Earned Abroad

If you qualify, you may choose to exclude a limited amount of your foreign earned income. You also may be able to claim an exclusion or a deduction from gross income for your housing costs. You will qualify for these provisions if your tax home is in a foreign country and you are either:

1) A U.S. citizen who is bona fide resident of a foreign country, or countries, for an uninterrupted period that includes a complete tax year, or

2) A U.S. citizen or resident alien who is physically present in a foreign country, or countries, for at least 330 full days during any period of 12 months in a row.

If you are required to live in a camp provided by or for your employer, you may also qualify to exclude the value of meals and lodging provided by your employer. See *Exclusion of employer-provided meals and lodging*, later.

A foreign country for this purpose means an area other than the 50 states, the District of Columbia, Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and U.S. possessions.

Waiver of time requirements. You may not have to meet the minimum time requirements for bona fide residence or physical presence if you have to leave the foreign country because war, civil unrest, or similar adverse conditions in the country prevented you from conducting normal business. You must, however, be able to show that you reasonably could have expected to meet the minimum time requirements if the adverse conditions had not occurred. See Publication 54 for a list of foreign countries that individuals have had to leave due to these conditions. If you

want to have an area placed on this list, write the Office of the Assistant Secretary for Tax Policy, Department of the Treasury, Washington, DC 20220.

Exclusion of foreign earned income. For tax years beginning after 1981, if your tax home is in a foreign country and you meet either the bona fide residence test or the physical presence test, you may choose to exclude from gross income a limited amount of your foreign earned income. Your income must be for services performed in a foreign country during your period of foreign residence or presence, whichever applies. If you are ***not*** an employee of the U.S. Government or any of its agencies, pay you receive from the U.S. Government or its agencies may qualify for the exclusion.

If you claim the exclusion, you may not claim a foreign tax credit or deduction for any foreign income tax paid on the excluded income. In addition, you may not claim the deduction for two-earner married couples if either you or your spouse claims the exclusion.

Amount excludable in 1983. If your tax home is in a foreign country and you qualify under either the bona fide residence or physical presence test for all of 1983, you may exclude the actual amount of foreign income earned during the year, up to a maximum of $80,000. However, if you qualify under either test for only part of 1983, you must reduce the $80,000 maximum exclusion on a pro rata basis.

Housing cost amount. For tax years beginning after 1981, if your tax home is in a foreign country and you meet either the bona fide residence or the physical presence test, you may claim an exclusion or a deduction from gross income for your housing cost amount.

Your ***housing cost amount*** is the excess of your allowable housing expenses for the tax year over a ***base amount***. Allowable housing expenses are the reasonable expenses (such as rent, utilities, and insurance) paid or incurred during the tax year by you, or on your behalf, for your foreign housing and that of your spouse and dependents if they lived with you. You may also include the allowable housing expenses of a second foreign household for your spouse and dependents if they did not live with you because of dangerous, unhealthful, or otherwise adverse living conditions. Housing expenses, for this purpose, do not include deductible interest and taxes.

The ***base amount*** is 16% of the annual salary, figured on a daily basis, of a U.S. Government employee in step 1 of grade GS-14 (currently $41,277 a year) multiplied by the number of days in your period of foreign residence or presence, whichever applies, that are within the tax year.

You may not claim the deduction for two-earner married couples if either you or your spouse claims an exclusion or deduction of the housing cost amount.

Exclusion. You may exclude your housing cost amount from income to the extent it is attributable to amounts your employer paid or incurred on your behalf.

If you claim the exclusion, you may not claim a foreign tax credit or deduction for any foreign income tax paid on the excluded income.

Deduction. If your housing cost amount is not provided by or for your employer, you may deduct it from gross in-

come to arrive at your adjusted gross income. ***However,*** the amount of the deduction may not be more than your foreign earned income for the tax year minus the amount of foreign earned income you exclude.

If you cannot deduct all of your housing cost amount in a tax year because of the limit, you may carry over the unused part to your next tax year. You may deduct from gross income this amount carried over to the extent the limit for that year (your foreign earned income minus the foreign earned income you exclude) exceeds your housing cost amount deduction for that year. You may not carry over any remaining amount to any future tax year.

Choosing the exclusion(s). You make the choice separately to exclude foreign earned income or to exclude or deduct your foreign housing cost amount. Once you choose to exclude your foreign earned income or housing cost amount, that choice remains in effect for that year and all future years unless you revoke it. You may revoke your choice for any tax year after the tax year for which you made the choice. However, except with the approval of the IRS, if you revoke your choice in a later tax year, such as by not claiming an exclusion even though you qualify, you may not claim the exclusion for your next 5 tax years.

Exclusion of employer-provided meals and lodging. If as a condition of employment you are required to live in a camp in a foreign country that is provided by or for your employer, you may exclude from gross income the value of any meals and lodging furnished. For this exclusion, a camp is lodging that is:

1) Provided for your employer's convenience because the place where you work is in a remote area where satisfactory housing is not available on the open market,
2) Located, as close as practicable, in the area of your worksite, and
3) Provided in a common area (or enclave) that is not available to the public and that normally houses at least ten employees.

Income From U.S. Possessions

If you have earned, or will earn, income from sources in a U.S. possession, you may be able to exempt that income from U.S. tax.

For information on the treatment of this income and special filing requirements, see Publication 570, *Tax Guide for U.S. Citizens Employed in U.S. Possessions.*

Foreign Income Taxes

A limited amount of the foreign income tax you pay may be credited against your U.S. tax liability or deducted in figuring taxable income on your U.S. income tax return. Generally, it is to your advantage to claim a credit for foreign taxes rather than to deduct them. A credit reduces your U.S. tax liability, and any excess may be carried back and carried forward. A deduction only reduces your taxable income and may be taken only in the current year.

Tax credit. If you choose to credit foreign taxes against your tax liability, use Form 1116, *Computation of Foreign Tax Credit,* and attach it to your U.S. income tax return.

Limit. Your credit is limited to the part of your U.S. income tax liability allocable to your taxable income from sources outside the United States. So, if you have no U.S. income tax liability, or if all your foreign income is exempt from U.S. tax, you will not be able to claim a foreign tax credit.

If the foreign taxes you paid or incurred during the year exceed the limit on the amount of your credit for the current year, you may carry back the unused foreign taxes as credits to your 2 previous tax years and then carry forward any remaining unused foreign taxes to your 5 succeeding tax years.

Foreign taxes paid on excluded income. You may not claim a credit for foreign taxes paid on amounts excluded from gross income under the exclusion of foreign earned income or the housing cost amount exclusion, discussed earlier.

Recapture of foreign losses. If you have an overall loss from foreign sources in a tax year and use the loss to offset income from U.S. sources, your loss is subject to recapture in later years when you have taxable income from foreign sources. You recapture it by treating a part of your taxable income from foreign sources in that later year as taxable income from U.S. sources. This reduces the foreign tax credit by decreasing the amount of foreign source income used in figuring the limit.

International boycott. If you participate in or cooperate with an international boycott during the tax year, the amount of foreign tax credit allowable is reduced. However, you may deduct any foreign tax that is not allowed as a credit.

Deduction. If you choose to deduct all foreign income taxes on your U.S. income tax return, itemize the deduction on Schedule A (Form 1040). You may not deduct foreign taxes paid on excluded income.

The foreign tax credit and deduction, their limits, and the carryback and carryover provisions are discussed in detail in Publication 514, *Foreign Tax Credit for U.S. Citizens and Resident Aliens.*

Tax Treaty Benefits

United States tax treaties or conventions with many foreign countries entitle U.S. citizens and residents to certain credits, deductions, exemptions, and reduced tax rates. In this way, you may be able to pay a lower amount of tax to those countries.

For example, most tax treaties allow U.S. residents to exempt part or all of their income for personal services from the treaty country's income tax if they are in the treaty country for a limited number of days.

Treaties also generally provide U.S. students, teachers, and trainees with special exemptions from the treaty country's income tax.

Publication 54, *Tax Guide for U.S. Citizens Abroad,* contains a general discussion of tax treaties and conventions and tells you how you may get copies of them.

Filing Requirements

The filing requirements for U.S. citizens and resident aliens in foreign countries are generally the same as those for citizens and residents living in the United States. Your age, marital status, and gross income determine whether you must file a U.S. federal income tax return. To determine if you meet the gross income requirement for filing purposes, you must include all income you receive from foreign sources as well as your U.S. income. It does not matter that:

- The income is paid in foreign money, or
- The foreign country imposes an income tax on that income, or
- The foreign income may be exempt from U.S. tax.

Self-employed persons. You must file a U.S. income tax return if you had $400 or more of net earnings from self-employment, regardless of your age. You must pay self-employment tax on your self-employment income. Net earnings from self-employment include the income earned both in a foreign country and in the United States.

Withholding tax. You may be able to have your employer discontinue withholding from all or a part of your wages. You may do this if you expect to qualify for the exclusions of income under either the bona fide residence test or the physical presence test. See Publication 54 for information.

Estimated tax. If you are working abroad for a foreign employer, you may have to pay estimated tax, since not all foreign employers withhold U.S. tax from your wages.

Your estimated tax is the total of your estimated income tax and self-employment tax for the year minus your expected withholding for the year.

When you estimate your gross income, do not include the income that you expect to be excluded. You may subtract the estimated amount of your housing cost deduction in figuring your estimated tax liability. However, if the actual amount of the exclusion or deduction is less than you anticipated, you may be subject to a penalty on the amount of the underpayment.

Use Form 1040-ES, *Estimated Tax for Individuals*, to estimate your tax. The requirements for filing and paying estimated tax are generally the same as if you were in the United States.

When to file. If your tax year is the calendar year, the due date for filing your income tax return is April 15 of the following year. If your tax year is a fiscal year (a 12-month period that does not end December 31), your due date for filing is the 15th day of the 4th month following the end of your fiscal year. The due date for the first installment of your estimated tax for the current year is the same as that for filing your income tax return for the previous year.

Extensions of time to file. U.S. citizens or residents who are traveling or residing outside the United States and Puerto Rico on their due date for filing are given an automatic 2-month extension of time in which to file their in-

come tax returns and their estimated tax. You do not have to file a special form to receive this extension.

It may benefit you to file for an additional extension of time to file if, on the due date for filing, you have not yet met either the bona fide residence test or the physical presence test, but you expect to qualify after the automatic 2-month extension and to receive a refund or to owe no tax. To file for this additional extension, send Form 2350, *Application for Extension of Time to File U.S. income Tax Return*, to the Internal Revenue Service Center in Philadelphia or to your local IRS representative. Send the form after the close of your tax year but before the due date (including the automatic 2-month extension) for filing your return. If an extension is granted, it will be to a date after you expect to meet the time requirements for the bona fide residence or physical presence test. You must attach the approved Form 2350 to your income tax return when you file it.

Where to file and pay. If you claim the exclusion of foreign earned income, the housing cost amount exclusion or deduction, or the possession exemption, send your tax return, related forms and schedules, and any tax due to the Internal Revenue Service Center, Philadelphia, PA 19255.

All other taxpayers should see Publication 54, *Tax Guide for U.S. Citizens Abroad*, or the instructions for Form 1040.

Foreign bank and financial accounts. If you had any financial interest in, or signature or other authority over, a bank account, securities account, or other financial account in a foreign country at any time during the tax year, you may have to complete Treasury Department Form 90-22.1 and file it with the Treasury Department.

You may get Form 90-22.1 from the offices listed under *Overseas Taxpayer Assistance and Information*.

Overseas Taxpayer Assistance and Information

You may find that for your first year abroad, because of your change of address, you do not receive a federal income tax forms package in the mail. The Internal Revenue Service has combined the Form 1040 package with the special forms and instructions needed by citizens living abroad. These forms and instructions are included in the Overseas Tax Package. You may get the package free by writing to the Foreign Operations District, Internal Revenue Service, Washington, DC 20225.

Tax forms and publications are available all year from IRS offices located in Bonn, Caracas, Jidda, Johannesburg, London, Manila, Mexico City, Nassau, Ottawa, Paris, Rome, São Paulo, Singapore, Sydney, Tokyo, and Vancouver.

During the filing period, you can also get the necessary federal income tax forms and publications from U.S. embassies and consulates abroad.

If you need help or information about your federal tax liability that you cannot get from the forms and publications, write to the Foreign Operations District, Internal Revenue Service, Washington, DC 20225.

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